THE SOUTHLAND CORPORATION

Annual Report 1965

BOARD OF DIRECTORS

WEBSTER ATWELL,	Partner, Atwell, Grayson & Atwell
J. Y. BALLARD,	Vice President Consulting Engineer
WALTON GRAYSON, III,	Vice President and General Counsel Partner, Atwell, Grayson & Atwell
H. E. HARTFELDER,	Executive Vice President
W. W. OVERTON, JR.,	Chairman of the Board, Texas Bank & Trust Company
JOHN P. THOMPSON,	President
JERE W. THOMPSON,	Vice President
CLIFFORD W. WHEELER,	Vice President

OFFICERS

JOHN P. THOMPSON,	President
H. E. HARTFELDER,	Executive Vice President
JERE W. THOMPSON,	Vice President, Store Operations
M. T. COCHRAN, JR.,	Vice President, Dairy Operations
CLIFFORD W. WHEELER,	Vice President, New Areas
J. Y. BALLARD,	Vice President
WALTON GRAYSON, III,	Vice President and General Counsel
W. K. RUPPENKAMP,	Treasurer
J. B. LANGFORD,	Secretary
R. G. SMITH,	Controller

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HIGHLIGHTS OF THE YEAR

	1964	1965
Total Revenues	$274,042,011	$333,349,865
Net Earnings (after taxes)	$ 3,646,302	$ 4,529,187
per share	1.08	1.30
Net Working Capital	$ 27,811,746	$ 32,405,685
current ratio	2.61 to 1	2.24 to 1
Long Term Debt	$ 29,189,881	$ 29,265,605
Stockholder's Equity	$ 19,653,028	$ 25,111,406
per share	5.84	7.23
Cash Dividends	$ 1,081,113	$ 1,105,768
per share	.32	.32

TO OUR STOCKHOLDERS:

Your company, in 1965, enjoyed another year of growth and accomplishment. Sales and earnings continued to climb and reached new high levels.

Total revenues increased 21.6 percent to $333,349,865 and net earnings rose 24.2 percent to $4,529,187. On a per share basis, earnings were $1.30, compared with the previous year's $1.08, adjusted for a special 2 percent stock dividend declared in October. In addition, cash dividends totaling $1,105,768 were paid to stockholders.

Important new operations were added, continuing our program of expansion in both store and dairy operations. A total of 1,894 stores were in operation at the end of 1965, representing an increase of 369 units. Our dairy operations were extended into the California market through the purchase of Spreckels-Russell Dairy in San Francisco and Adohr Milk Farms in Los Angeles. On February 1, 1966, Southland completed the purchase of Harbisons Dairies in Philadelphia. Because of their excellent market position and fine consumer acceptance these new dairies give added strength to our earnings potential.

Support for our continuing expansion is being provided through improved administrative activities. The requirements for qualified personnel are being satisfactorily filled from the ranks of our more than 10,000 competent employees. Advertising programs are being broadened to include network radio and general consumer magazines such as Life and Look.

New construction, equipment and the larger inventories necessitated by our increasing sales are being financed by current earnings and through the placement of $27,500,000 in long term promissory notes in January, 1966, which will be utilized as needed over the next two years.

We have started the new year confident that our planning is sound and that our organization is prepared to meet the challenges of growth. The public acceptance of the convenience store concept and the extent of the yet undeveloped markets present excellent opportunities. Our future programs for store construction, plant modernization, training and financing are designed to capitalize on these opportunities.

Our policies and actions have carried us to a new position as one of the fifty largest merchandising firms in the United States. We are dedicated to strengthening and advancing that position for the benefit of our customers, our employees and you, our stockholders.

Sincerely,

John P Thompson
JOHN P. THOMPSON
President

H. E. Hartfelder
H. E. HARTFELDER
Executive Vice President

JERE W. THOMPSON
Vice President,
Store Operations

CLIFFORD W. WHEELER
Vice President,
New Areas

VAUGHN HEADY
Southwestern
Division Manager

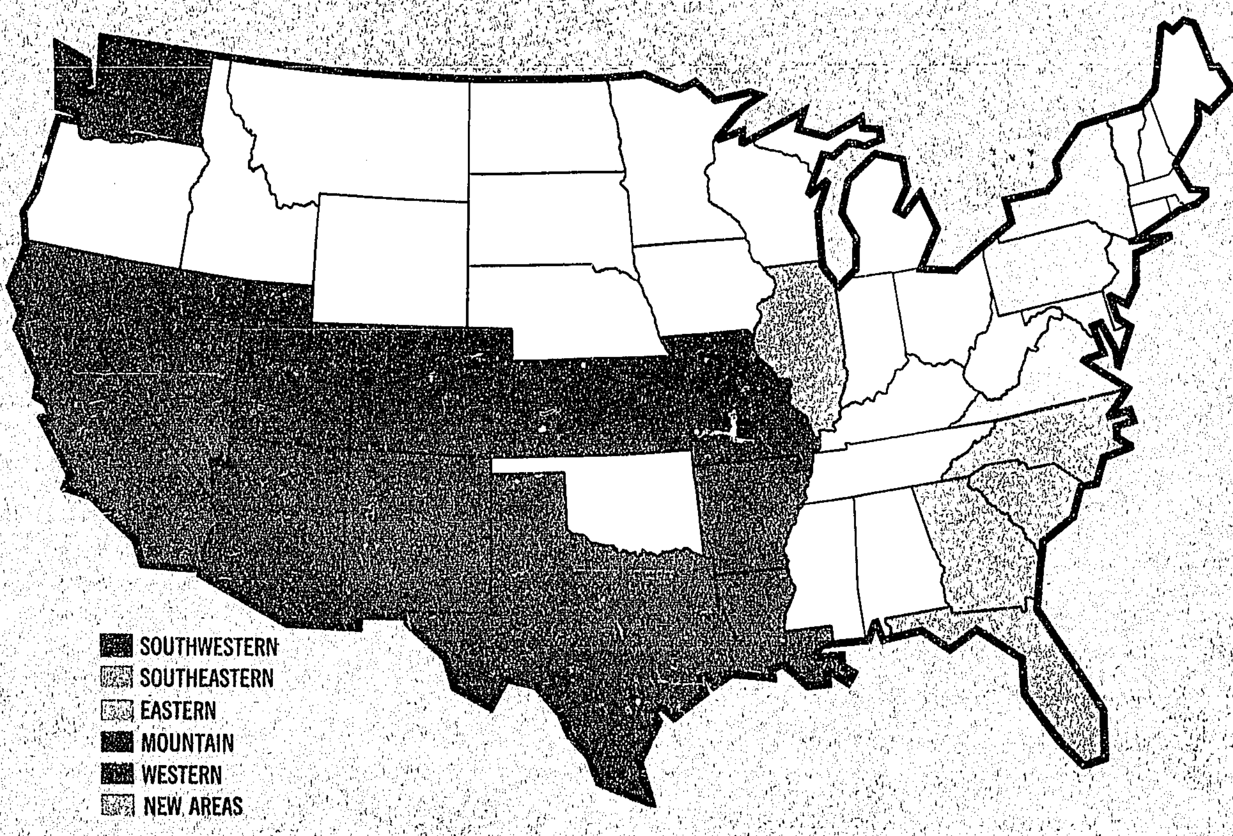
D. C. NEALE
Southeastern
Division Manager

FORREST STOUT
Eastern
Division Manager

BEN M. HOLLAND
Mountain
Division Manager

S. C. MEYER
Western
Division Manager

SOUTHLAND STORE DIVISIONS



STORE OPERATIONS

During 1965, Southland's convenience store operations continued to grow in terms of sales, number of stores and geographical market area.

Sales were increased through new merchandising efforts, special promotions and greater attention to customer product preference. An expanded advertising program is utilizing regional and national media of all types to more fully acquaint our customers with the advantages of convenience food store locations, hours and fast, friendly service.

The total number of stores was increased 24 percent, continuing Southland's long range development program. Intensive market research, site selection and personnel training have enabled store operations to grow from 591 to 1,894 units in just five years.

New market development was accelerated in the East and Midwest, and construction was begun on Southland's first stores in the Chicago metropolitan area, a market of 7,000,000 population. Store franchising, used successfully by the Western Division, will continue to be an important part of the company's future development plans.

As a part of the retail food industry for over 38 years Southland continues to meet the growing demand for shopping convenience and to increase its lead as the largest operator of convenience food stores in the United States.

Southland's store operations are administered through these five geographic divisions:

SOUTHWESTERN DIVISION—headquartered in Dallas; 7-Eleven and Minit Market stores in Texas, Louisiana, Arkansas and New Mexico.

SOUTHEASTERN DIVISION—headquartered in Miami; 7-Eleven stores in Florida, Georgia, South Carolina and North Carolina.

EASTERN DIVISION — headquartered in Washington, D. C.; 7-Eleven and Minit Market stores in New York, Pennsylvania, Maryland, Delaware, Virginia, New Jersey and District of Columbia.

MOUNTAIN DIVISION — headquartered in Denver; 7-Eleven stores in Colorado, Utah, Arizona, Kansas and Missouri.

WESTERN DIVISION — headquartered in San Diego; Speedee 7-Eleven stores in California, Washington and Nevada.


M. T. COCHRAN, JR.
Vice President,
Dairy Operations


BRUCE FURRH
North Oak Farms
Division Manager


MAURICE PALMER
South Oak Farms
Division Manager


JACK HARTFELDER
Cabell's
Division Manager


KARL SCHMIDT
North Midwest Farms
Division Manager


V. C. REICHERT
South Midwest Farms
Division Manager


MASON COPELAND
Velda Farms
Division Manager


PAUL HAMMOND
Delvale
Division Manager


J. RIDGELY PARKS
Embassy
Division Manager

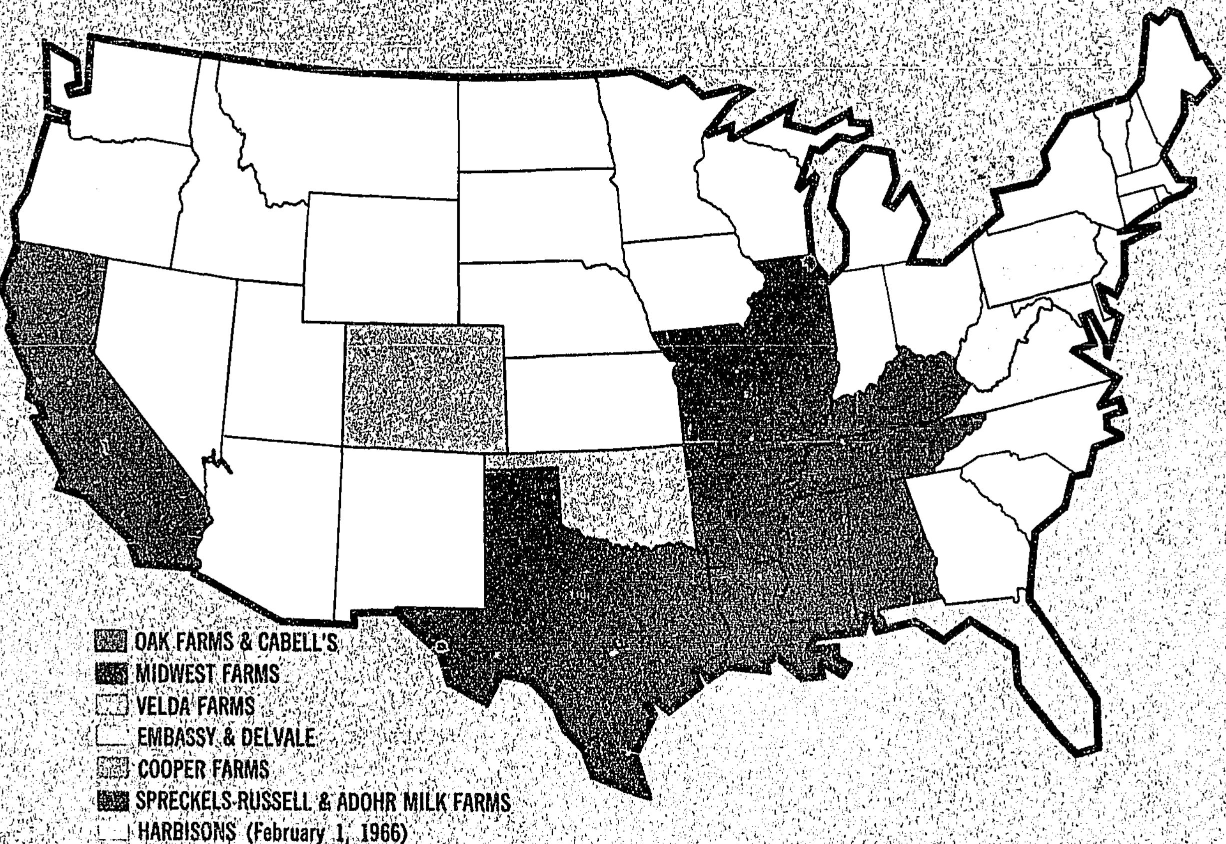

W. J. HUNT
Cooper Farms
Division Manager


L. B. SMITH
Spreckels-Russell
Division Manager


J. R. SMITH
Adohr Milk Farms
Division Manager


W. J. HOUSE
Western
Region Manager

SOUTHLAND DAIRY DIVISIONS



DAIRY OPERATIONS

The Southland Corporation's dairy operations were extended to the West Coast with the addition, in 1965, of Spreckels-Russell Dairy and Adohr Milk Farms, located in California.

Founded in San Francisco in 1908, Spreckels-Russell produces a full line of quality dairy products and enjoys one of the most highly respected brand names in Northern California.

Adohr Milk Farms became the company's second West Coast dairy on December 1, 1965. A leader in the Los Angeles metropolitan area, Adohr has one of the largest dairy home delivery businesses in the United States. The quality of its products has earned the company numerous industry awards over the past 50 years.

The overall dairy modernization program progressed with the installation of new equipment and methods, the standardization of packaging and the development of new products. Increased sales and lower expenses resulting from this program will continue to be reflected in operating results.

Today, Southland's dairy brands hold increasingly strong positions in the principal markets of 19 states and the District of Columbia. In addition to supplying Southland stores, the dairy divisions sell the major portion of their output to a growing number of home delivery customers, institutions and other retail food outlets.

These dairy operations are organized into the following product divisions:

OAK FARMS DIVISIONS — North Oak Farms headquartered in Dallas, South Oak Farms in Houston; distribution of Oak Farms products in Texas, Camellia Ice Cream in Houston, and Goble's products in Wichita Falls.

CABELL'S DIVISION — headquartered in Dallas; distribution in East, West and North Central Texas.

MIDWEST FARMS DIVISIONS — North Midwest headquartered in Memphis, South Midwest in Shreveport; distribution of Midwest and Fortune products in Illinois, Missouri, Kentucky, Tennessee, Arkansas, Louisiana, Mississippi and Alabama.

VELDA FARMS DIVISION — headquartered in Miami; distribution throughout Florida.

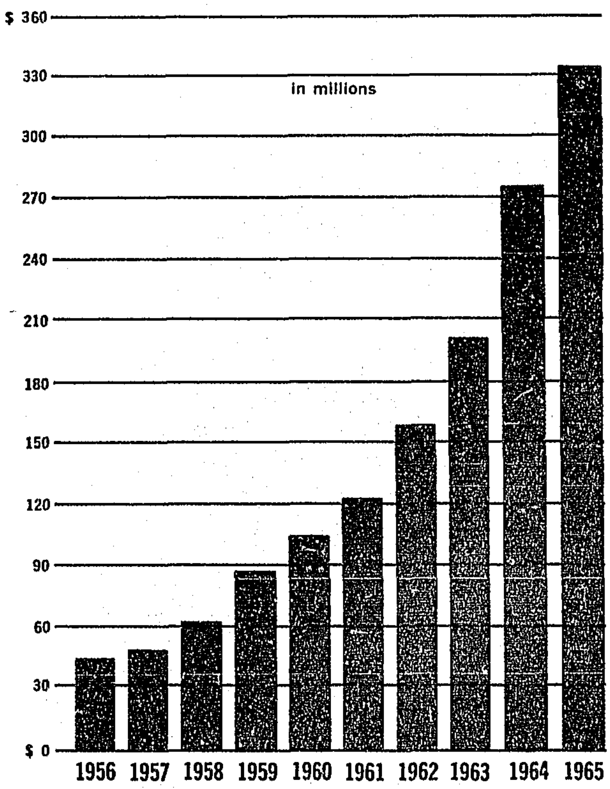
DELVALE DIVISION — headquartered in Baltimore; distribution of Delvale Ice Cream in Virginia, Maryland, Delaware, New Jersey, Pennsylvania and the District of Columbia and operation of a number of Baskin-Robbins ice cream shops.

EMBASSY DIVISION — headquartered in Washington, D. C.; distribution of Embassy Milk products in Maryland, Virginia and District of Columbia.

COOPER FARMS DIVISION — headquartered in Ardmore; distribution of Cooper Farms products in Oklahoma and Oak Farms products in Colorado.

SPRECKELS-RUSSELL DIVISION — headquartered in San Francisco; distribution in San Francisco and the Bay Area.

ADOHR MILK FARMS DIVISION — headquartered in Los Angeles; distribution in Los Angeles and surrounding counties.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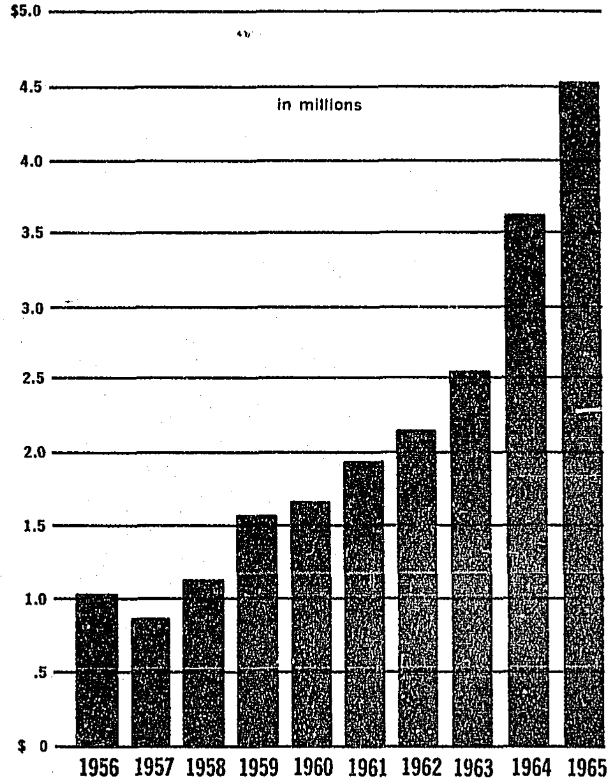
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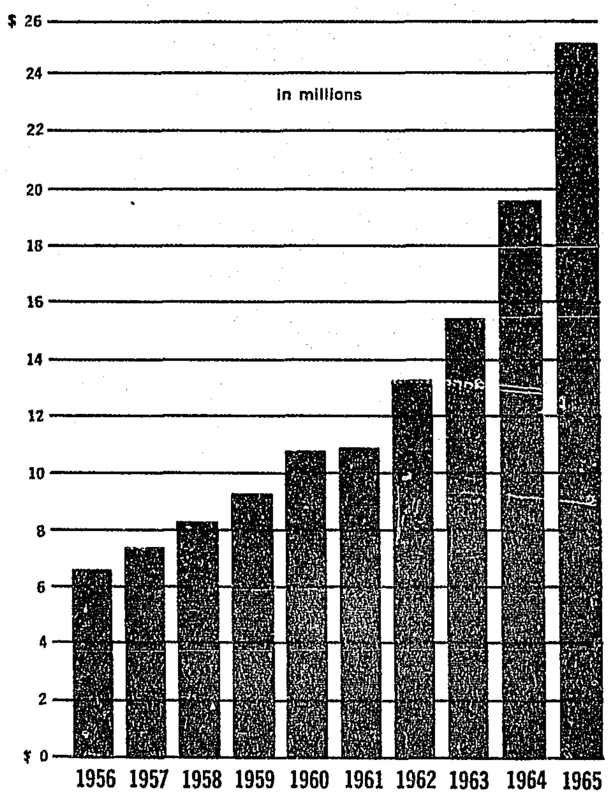
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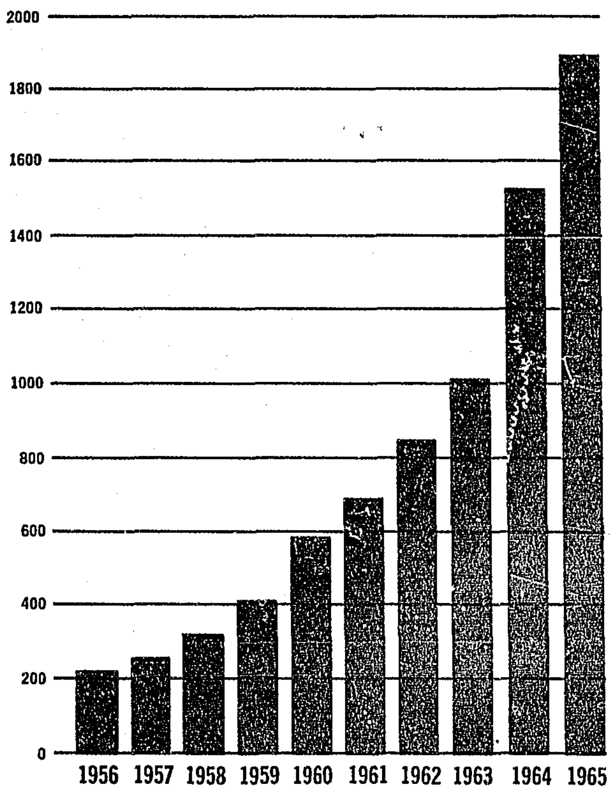
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STATEMENT OF CONSOLIDATED EARNINGS

	Year ended December 31	
	1964	**1965**
REVENUES:		
Net sales (including franchisee stores)	$273,973,135	$332,940,351
Other income	68,876	409,514
	$274,042,011	$333,349,865
COST OF SALES AND EXPENSES (Note 8):		
Cost of sales and expenses exclusive of items listed below	$250,663,912	$304,608,574
General and administrative expenses	1,818,517	2,517,730
Property and equipment rentals (Note 7)	10,349,529	12,761,569
Depreciation	1,789,490	1,725,226
Interest expense	1,042,034	1,782,626
Contributions to employees' savings and profit-sharing fund	833,227	1,002,953
	$266,496,709	$324,398,678
NET EARNINGS BEFORE FEDERAL TAXES ON INCOME	$ 7,545,302	$ 8,951,187
FEDERAL TAXES ON INCOME	3,899,000	4,422,000
NET EARNINGS	$ 3,646,302	$ 4,529,187

See notes to financial statements.

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31 1964	December 31 1965
CURRENT ASSETS:		
Cash	$ 12,148,752	$ 9,868,549
Accounts and notes receivable:		
Trade	$ 5,097,783	$ 8,030,387
Franchisee	1,656,860	2,995,362
Other	2,258,483	2,773,366
	$ 9,013,126	$ 13,799,115
Less allowance for doubtful accounts	242,488	297,669
	$ 8,770,638	$ 13,501,446
Inventories, at the lower of cost or market:		
Merchandise	$ 16,467,482	$ 19,321,516
Supplies	1,813,526	2,132,270
	$ 18,281,008	$ 21,453,786
Deposits and prepaid expense	$ 1,657,707	$ 1,551,363
Investment in property (Note 2)	$ 4,192,677	$ 12,073,787
TOTAL CURRENT ASSETS	$ 45,050,782	$ 58,448,931
INVESTMENTS AND OTHER ASSETS	$ 719,692	$ 726,535
PROPERTY, PLANT AND EQUIPMENT, at cost (Note 4):		
Land	$ 5,739,996	$ 6,744,841
Buildings and leaseholds	17,750,614	20,165,231
Machinery and equipment	10,015,987	9,869,916
Vehicles	3,731,944	2,459,373
Construction in process	233,800	216,524
	$ 37,472,341	$ 39,455,885
Less accumulated depreciation	15,860,638	16,310,380
	$ 21,611,703	$ 23,145,505
	$ 67,382,177	$ 82,320,971

See notes to financial statements.

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1964	December 31 1965
CURRENT LIABILITIES:		
Notes payable to banks	$ 1,000,000	$ 750,000
Long-term debt due within one year	1,145,612	1,795,363
Accounts payable and accrued expense	12,941,849	21,432,532
Federal income tax	2,151,575	2,065,351
TOTAL CURRENT LIABILITIES	$ 17,239,036	$ 26,043,246
DEFERRED CREDITS (Note 3)	$ 1,050,226	$ 1,620,759
RESERVES FOR SELF INSURANCE	$ 250,006	$ 279,955
LONG-TERM DEBT (Note 4):		
5⅛ % Promissory note due 1978	$ 4,500,000	$ 4,500,000
Note obligations, property and equipment pledged	13,439,881	13,515,605
5% Convertible subordinated notes due 1984	11,250,000	11,250,000
	$ 29,189,881	$ 29,265,605
STOCKHOLDERS' EQUITY (Notes 4, 5 and 6):		
Common stock, $.01 par value, authorized 10,000,000 shares, issued and outstanding 3,471,908 shares in 1965 and 3,299,506 shares in 1964	$ 32,995	$ 34,719
Additional paid-in capital	4,742,104	8,514,171
Earnings retained in the business	14,877,929	16,562,516
	$ 19,653,028	$ 25,111,406
CONTINGENCIES AND COMMITMENTS (Note 7)		
	$ 67,382,177	$ 82,320,971

STATEMENT OF CONSOLIDATED STOCKHOLDERS' EQUITY

Year ended December 31, 1965

COMMON STOCK:		
Balance January 1, 1965	$ 32,995	
Sale of common stock	605	
Exercise of stock options	437	
2% stock dividend	682	
Balance December 31, 1965		$ 34,719
ADDITIONAL PAID-IN CAPITAL:		
Balance January 1, 1965	$ 4,742,104	
Sale of common stock	1,572,097	
Exercise of stock options	458,401	
Excess of market value over par value of 2% stock dividend	1,741,569	
Balance December 31, 1965		8,514,171
EARNINGS RETAINED IN THE BUSINESS:		
Balance January 1, 1965	$ 14,877,929	
Net earnings for the year	4,529,187	
	$ 19,407,116	
Cash dividends	$ 1,105,768	
2% stock dividend	1,738,832	
	$ 2,844,600	
Balance December 31, 1965		16,562,516
TOTAL STOCKHOLDERS' EQUITY (Notes 4, 5 and 6)		$ 25,111,406

See notes to financial statements.

CHANGES IN NET WORKING CAPITAL

Working Capital, Dec. 31, 1964			$27,811,746
Additions:			
Net Earnings	$4,529,187		
Depreciation	1,725,226		
Deferred Credits	570,533		
Long-term Debt	75,724		
Sale of Stock	2,034,959		
Other (net)	23,106	$8,958,735	
Deductions:			
Dividends	$1,105,768		
Plant and equipment	3,259,028	4,364,796	
			4,593,939
Working Capital, Dec. 31, 1965			$32,405,685

NOTES TO FINANCIAL STATEMENTS

Year ended December 31, 1965

***NOTE 1** — Principles of Consolidation:*

The financial statements contain the assets, liabilities, sales, and costs and expenses of all domestic subsidiaries. A foreign subsidiary which is relatively minor has not been consolidated. Intercompany transactions have been eliminated in consolidation.

***NOTE 2** — Investment in Property:*

Investment in property includes land and buildings to be pledged as collateral under long-term obligations or to be sold to outsiders. Amounts have been reclassified as of December 31, 1964, to make the years comparable.

***NOTE 3** — Deferred Credits:*

For financial reporting purposes, investment credits relating to leased and purchased property and equipment, which are allowed as credits against federal income taxes, are taken into income ratably over the useful life of the assets or the term of the leases, respectively.

***NOTE 4** — Long-term Debt:*

5⅛% Promissory note due 1978:

Refinanced effective Janaury 25, 1966, through issuance of 5¾% notes due January 1, 1976, as described below.

Note obligations, property and equipment pledged:

Approximately 60% of the net carrying value of property and equipment (primarily real estate) is pledged under various notes having interest rates ranging from 5% to 6% and maturity dates from 1967 to 1981. Payments of principal and interest are made monthly and aggregate approximately $1,837,000 annually.

5% Convertible subordinated notes due 1984:

Principal payments are due annually, beginning in 1975, in amounts equal to 10% of the aggregate principal amount of notes outstanding on December 31, 1974.

Notes are convertible at the rate of 30 30/33 shares of capital stock for each $1,000 unpaid principal amount of notes prior to January 1, 1975, and at the rate of 27 2/10 shares subsequent thereto. Of the Company's unissued capital stock, 347,728 shares are reserved for conversion of these notes.

5¾% Notes due 1976:

Effective January 25, 1966, the Company entered into Note and Credit Agreements whereby the Company will borrow $27,500,000 on or before January 2, 1968, as provided in the agreements. The 5⅛% promissory note due 1978 and indenture under which the 5⅛% note was issued were thereby cancelled. Quarterly principal payments begin April 1, 1968, in the amount of $859,375, the final payment being January 1, 1976.

The indentures under which the 5¾% and 5% notes were issued place certain restrictions on the payment of cash dividends. Under the most restrictive of these provisions, retained earnings totaling $2,548,000 at December 31, 1965, were not so restricted. Other provisions of the loan agreements include the requirements that consolidated working capital be not less than $20,000,000 and that consolidated net worth be not less than $15,000,000, as these terms are defined in the agreement. The Company has complied with the above requirements.

***NOTE 5** — Stockholders' Equity:*

On October 27, 1965, the Board of Directors declared a 2% stock dividend payable as of January 10, 1966, to stockholders of record December 10, 1965. The number of shares issued for the stock dividend is included in capital stock outstanding at December 31, 1965. The market value of the shares issued has been transferred from earnings retained in the business to capital stock and additional paid-in capital. Where shares have been stated in the notes to the financial statements, the number of shares give effect to the 2% stock dividend.

***NOTE 6** — Stock Options:*

At December 31, 1965, options for 192,719 shares of the Company's stock, at prices ranging from $2.47 to $28.92 were outstanding, of which 31,447 shares were exercisable. During 1965, 44,556 shares were issued upon exercise of options at prices ranging from $2.26 to $28.92; options were granted for 22,533 shares at $26.72 per share; and options for 5,412 shares expired or were cancelled.

An additional 80,503 shares are available for future grants under the employees' stock option plan.

***NOTE 7** — Contingencies and Commitments:*

Lease commitments:

The Company leases a substantial portion of the property and equipment. Annual rental

payments under lease agreements are as follows:

	Minimum annual payments	
	All leases	Leases having terms 3 years and over
Property leases	$ 8,370,000	$ 7,935,000
Equipment leases	6,690,000	6,055,000
	$15,060,000	$13,990,000

Property leases range generally from 10 to 25 years and equipment leases range from 5 to 10 years. In addition to minimum annual rentals, certain leases require payments of taxes and insurance (such amounts being included under other operating expenses).

NOTE 8 — *Classification of Cost of Sales and Expenses in Annual Report to the Securities and Exchange Commission:*

Cost of goods sold, including buying and occupancy expenses	$277,757,501
Selling, general and administrative expenses	43,855,598
Interest expense	1,782,626
Contributions to employees' savings and profit-sharing fund	1,002,953
	$324,398,678

TOUCHE, ROSS, BAILEY & SMART

DALLAS FEDERAL SAVINGS BUILDING
DALLAS, TEXAS 75201

Board of Directors and Stockholders,
The Southland Corporation,
Dallas, Texas.

We have examined the accompanying consolidated balance sheet of The Southland Corporation and subsidiaries as of December 31, 1965, and the related statements of earnings and stockholders' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements referred to above present fairly the consolidated financial position of The Southland Corporation and subsidiaries at December 31, 1965, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey & Smart
Certified Public Accountants.

Dallas, Texas.
February 14, 1966.

10 YEARS OF GROWTH

	1956	1957	1958
TOTAL REVENUES ....*...........	$ 42,995	$ 49,967	$ 60,754
NET EARNINGS (Note 2)..................*...........	1,012	858	1,142
NET WORKING CAPITAL ....*...........	2,069	2,945	3,643
PROPERTY, PLANT & EQUIPMENT (Net).......*...........	6,805	6,478	6,485
LONG TERM DEBT ....*...........	2,467	2,056	1,925
STOCKHOLDER EQUITY ....*...........	6,505	7,364	8,200

*(000 omitted)

	1956	1957	1958
PER SHARE OF COMMON STOCK:			
NET EARNINGS (Note 3)..............................	.32	.27	.36
CASH DIVIDENDS (Note 4)...........................	—	.04	.11
NUMBER OF SHARES (Note 3)...........................	3,131,840	3,131,840	3,134,838

1959	1960	1961	1962	1963	1964	1965
$ 88,955	$ 105,278	$ 120,117	$ 159,609	$ 202,524	$ 274,042	$ 333,350
2,035	1,674	1,560	2,171	2,586	3,646	4,529
3,840	4,880	4,527	4,307	8,014	27,812	32,406
9,661	10,218	11,135	14,145	19,612	21,612	23,146
3,590	3,944	4,635	5,107	11,795	29,190	29,266
9,612	10,763	10,947	13,249	15,443	19,653	25,111
.65	.53	.49	.67	.79	1.08	1.30
.12	.15	.18	.25	.28	.32	.32
3,140,155	3,146,611	3,153,242	3,241,467	3,288,563	3,365,496	3,471,908

NOTES:

(1) Includes The Southland Corporation and subsidiaries. Data for businesses acquired under the pooling of interests concept have been included for years prior to their acquisition by The Southland Corporation.

(2) Years 1956 through 1961 include the earnings of partnerships acquired in 1962 after giving effect to corporate federal income tax. Net earnings include special items of $449,000 (addition) in 1959, and $393,000 (deduction) in 1961.

(3) Calculations of earnings per share are based upon the number of shares outstanding at the end of the respective years after giving effect to subsequent stock dividends, stock split and shares issued in exchange for businesses acquired under the pooling of interests concept.

(4) Cash dividends per share include distributions of the parent company only.